HOUSING MARKET OUTLOOK

Sherbrooke

Canada Mortgage and Housing Corporation

www.cmhc.ca

FALL 2006

Economic Context Becoming Less Favourable to Real Estate

The contraction in full-time employment in the Sherbrooke area will contribute to weakening the housing markets in 2007. No major drop in activity is to be expected, however, as immigrants will continue to arrive in large numbers, which will help stimulate the housing demand. In addition, mortgage rates will still be relatively low and will remain practically stable in 2007, in relation to the second half of 2006. The decline in construction next year will bring starts back to 930 units, quite close to the average level for the last 33 years (995 units).

Employment in the manufacturing sector, which has been experiencing difficulties in the Estrie area since 1999, continues to be hard hit by the strength of the Canadian dollar and increased competition from foreign countries. The latest example in the list, Spring Canada, a plant related to the textile sector, shut down in May, laying off 40 people. As well, the lack of skilled labour, like welders or assemblers, is another factor that is intensifying the slowdown in the manufacturing sector.

The trade and service sectors are continuing their attempts to take up

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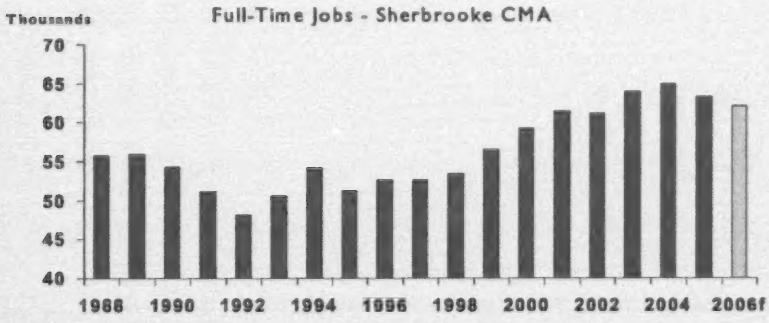
Full-Time Jobs Decline



Source: Statistics Canada f: CMHC forecasts

the slack, in terms of job creation, as evidenced by the significant investments announced by Home Depot, Canadian Tire, Mazda, Nissan, L'Équipeur, Métro Rock Forest, Métro Plus Plouffe, Boston Pizza, Super C and others. However, the jobs generated by these sectors are usually part-time and with below-average pay.

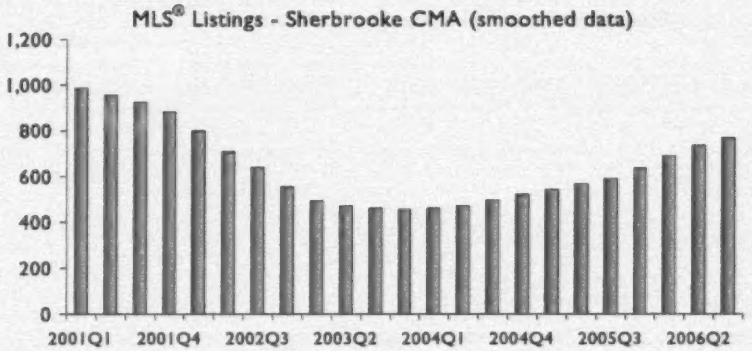
As a result, even though employment will grow by 500 and 800 jobs in 2006 and 2007, respectively, full-time employment will continue to contract over this period. During the first half of 2006, the Sherbrooke area lost 1,400 full-time positions.

The consumer confidence index, which is generally on the decline, is also showing signs of deteriorating conditions. More particularly, fewer and fewer Quebec residents think that now is a good time to make a major outlay for an item such as a home or car. Despite this decrease, consumer confidence still remains at a relatively high level.

A combination of a slowing economy, strong Canadian dollar vis-à-vis the U.S. dollar, and moderate inflation will help keep Canadian interest and mortgage rates low over the remainder of this year and in 2007.

Mortgage rates rose by 1.0-1.5 percentage point between September 2005 and September 2006. Mortgage rates are expected to remain low, easing by 25-75 basis points over the next two-three quarters before starting to climb higher. One three and five-year posted mortgage rates are forecast to be in the 5.5-6.50, 5.75-6.75, and 6.0-7.00 per cent ranges respectively over the rest of this year and in 2007.

Homes for Sale Rise Again



Sources: CMHC and Chambre immobilière de l'Estrie (CIE)

Rise in listings picks up the pace

There are more and more "For Sale" signs across the territory of the Sherbrooke CMA. During the summer, there were 733 of them, compared to 600 for the same period last year. The last time there was a similar number of listings dates back to 2001, right before the real estate boom began. The time required to sell a home has lengthened by one week (8 days) since the beginning of the year, and the average listing period has now reached 82 days. It is in the outskirts of the CMA, that is, the zone outside the city of Sherbrooke, that it takes the most time to conclude a transaction, at 114 days.

Even with the growing choice available to buyers, home sales are not taking off. On the contrary, they are falling slightly. The significant increase in prices over the last four years and the deterioration of the labour market (fewer full-time jobs and less well-paid new jobs) are starting to hinder the capacity of households to acquire a first property or buy a home that better meets their needs. The slowdown in sales will be negligible in 2006 (-2 per cent) but will intensify in 2007 (-7 per cent), as the negative impact of the deteriorating economic and financial conditions will affect the housing market.

Existing home price growth bound to slow

Over the months to come, the growth in home prices should continue to slow down. We should also see market conditions ease quite rapidly. This situation will result from a steady rise

[1] Two-bedroom units are often used to give and idea of the general trend on the market. Since the housing stock comprises many units of this type, the increase in posted rental rates is less biased by the arrival of new units, which are often very expensive in comparison with existing apartments.

Existing Home Sales Fall Slightly in 2007

Sources: CMHC and Chambre immobilière de l'Estrie (CIE) f: Forecasts

in the supply of homes for sale and a moderate slowdown in demand.

In 2006, the average price of MLS® transactions will reach $163,300, up by 6 per cent over last year. This will be the first time in four years that the increase in prices will be below 10 per cent. In 2007, the growth will be limited to 4 per cent.

As expected, the resale market has shifted from an overheated state in recent months to a seller's market, where it will remain over the forecast horizon. On an annual basis, the seller-to-buyer ratio stood at 6 to 1 in the third quarter, in comparison with 5 to 1 one year earlier.[1] In 2007, this situation will be consolidated, and the increase in prices will be limited to 4 per cent, which will bring the average price to $169,800. It will be necessary to wait until the market becomes balanced again for the growth in prices to move closer to inflation (±2 per cent).

The condominium segment stands out from the overall market. First of all, sales have been on the rise since the beginning of the year (+4 per cent). Also, this market is considerably less tight, with the seller-to-buyer ratio in the balanced range (10 to 1 since the spring). Often less expensive than single-family houses, condominiums represent an attractive solution, given that household budgets are increasingly tight. In 2007, the market will remain balanced even though the seller-to-buyer ratio may decrease slightly. With the production of new units having slowed significantly in 2005 and 2006, listings will follow suit in 2007, which should draw the seller-to-buyer ratio downward.

New home market: no decrease in starts until 2007

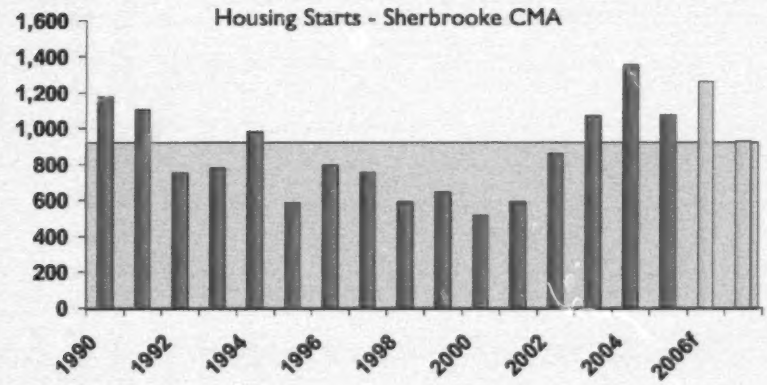
Housing starts are down in several areas across Quebec, but it will be necessary to wait until 2007 before this happens in Sherbrooke. This year, on account of the construction of a 279-unit retirement housing project, the number of starts will exceed last year's volume by 17 per cent. Without this project, however, the level of activity would have declined. In 2007, residential construction will fall by 26 per cent, as 930 units will get under way. While this decrease may seem significant, production will end up quite close to the average annual level for the period from 1973 to 2005 (995 units), during which demographic growth was greater than now.

Thanks to the major project mentioned above, rental apartment production will jump up this year (645 units, compared to 345 last year) and exceed freehold home building. This had not happened in many years, as we are in a cycle where ownership is the tenure of choice. Of course, the will to benefit from economies of scale and the fact that the developer is a national player are such that the first phase of this project is larger than what is generally observed on the Sherbrooke market. This residential project alone will meet the need for seniors' housing for at least three years. Next year, 400 rental housing units will be started. That being said, the demand for rental housing, which increases with the arrival of immigrants, and the decrease in unoccupied recent or expensive apartments in 2005 will limit the decline in rental unit production.

As for starts of freehold homes, mainly single-family houses, 2006 will mark the beginning of the contraction phase. With more and more existing properties for sale, there will be less of a need for people to turn to the new home market to become homeowners or meet their housing needs. In addition, deteriorating employment conditions and prospects will undermine buyer confidence. The slowdown will be progressive, as home starts will fall by 12 per cent this year and then by 15

[1] It should be noted that, on a balanced market, which equally favours buyers and sellers, the seller-to-buyer ratio stands between 8 and 10 to 1. A ratio above 10 to 1 signifies a buyer's market, while a ratio below 8 to 1 indicates a seller's market. A ratio under 5 to 1 reflects an overheated market.

Starts: No Major Drop in Sight



Source: CMHC f: Forecasts

per cent in 2007. In all, 585 freehold homes will be started in 2006, compared to 663 last year. For 2007, 400 new units are anticipated.

The average price of new single-detached houses will rise by 5 per cent this year and reach $185,500 in 2006. The presence of many baby boomers, namely, those who are doing the best on the labour market in the area, is not unrelated to this increase. Escalating construction costs, in a sector where demand for materials and labour remains high and labour is scarce, are also partly responsible for this price hike. In 2007, the growth in prices should be limited to 3.5 per cent, on account of the lower demand and also because of a change in the demand mix. During periods when demand declines significantly, developers start offering a wider range of products, which increases especially with the addition of less expensive models.

Since the existing condominium market offers a great deal of choice and is balanced, the construction of this type of housing will decline this year (30 units, versus 68 last year). Condominium starts are expected to stabilize in 2007, as the supply generally comes in spurts, with strong production years followed by periods with few or no new units. In 2004, 129 condominium units were built, which was a peak year for production. In the Sherbrooke area, condominiums do not serve as gateway to the real estate market for young families who want to access homeownership. They mainly meet the needs of young professionals, single people or seniors. By intensifying the competition, the arrival of major retirement homes will therefore contribute to slowing down the construction of condominiums intended for retirees and pre-retirees.

Vacancy rate to keep rising slowly

Over the forecast period, immigration will once again be the driving force behind the new demand for rental housing. The latest results show that international migration now represents some 1,300 people, after having shown a first surge (to 1,000 people per year) at the beginning of this decade. The appeal of the area should grow over the coming years, as it is felt that the government wants to encourage part of the newcomers to head toward certain smaller centres, like Sherbrooke. Apart from this factor that stimulates demand, the determining variables on the rental market will all be putting upward pressure on the vacancy rate over the next two years. The supply of new units will remain high in 2006 and increase in 2007, thanks, in part, to the 279 new retirement housing units being put on the market. And, this appreciable increase in the supply will occur at a time when the demand for rental housing will be declining on account of a less favourable labour market and a homeownership trend that will remain strong in 2006 before slowing down noticeably in 2007. These last factors will ease the upward pressure on the demand resulting from the increase in immigration. The vacancy rate will therefore rise gradually, from 1.2 per cent in 2005 to 1.6 per cent in 2006 and then to 2.2 per cent the following year.

Given that rents rise less significantly when the market eases, we forecast that the rents (for two-bedroom units[1]) on the Sherbrooke rental market will go up by about 2 per cent over the coming years.

[1] Smoothed data is then used.

[2] Two-bedroom units are often used to give and idea of the general trend on the market. Since the housing stock comprises many units of this type, the increase in posted rental rates is less biased by the arrival of new units, which are often very expensive in comparison with existing apartments.

FORECAST SUMMARY
Sherbrooke Census Metropolitan Area
Fall-Winter 2006

	2005	2006f	% Chg.	2007f	% Chg.
RESALE MARKET					
MLS® sales (1)	1,482	1,450	-2 %	1,350	-7 %
Average MLS® price ($) (1)	154,100	163,300	6 %	169,800	4 %
NEW HOME MARKET					
Housing starts					
Total	1,076	1,260	17 %	930	-26 %
Freehold	663	585	-12 %	500	-15 %
Rental	345	645	87 %	400	-38 %
Condominium	68	30	-56 %	30	0 %
Average price ($)					
Single-detached houses	177,110	185,500	5 %	192,000	3.5%
RENTAL MARKET					
Vacancy rate (October) (%)	1.2	1.6	n.d.	2.2	--
Rent (2-bedroom) ($)	505	515	2 %	528	3 %
ECONOMIC OVERVIEW					
Mortgage rate 1 - year (%)	4.6	5.1	6.3	(5.5 - 6.5)	--
Mortgage rate 5 - year (%)	6.2	6.0	6.7	(6.0 - 7.0)	--
Employment level	80,925	81,425	0,6 %	82,225	1,0 %
Employment growth (number)	-200	500	n.d.	800	--

(1) Data may....
f: CMHC forecasts
Sources: CMHC and Statistics Canada

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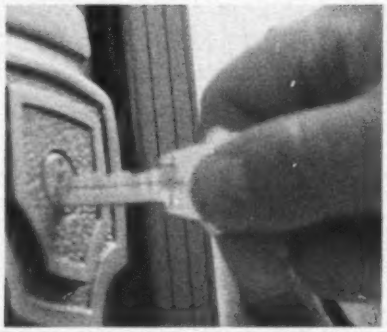

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